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C O N F I D E N T I A L CARACAS 003110

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HQ USSOUTHCOM FOR POLAD

E.O. 12958: DECL: 10/06/2014
TAGS: ECON EFIN PGOV VE
SUBJECT: PRESSURE ON CENTRAL BANK INCREASES ON THREE FRONTS

REF: A. CARACAS 1443
¶B. CARACAS 1943

Classified By: ECONOMIC COUNSELOR RICHARD M. SANDERS FOR REASON 1.4 B A ND D

SUMMARY

¶1. (C) The GOV has renewed pressure on the Venezuelan Central Bank (BCV), by again demanding a large sum of money. It asserts the BCV owes more than USD 2 billion from improperly accounting for foreign exchange profits. While the BCV has resisted this demand, it may be caving in another area. It recently changed its retirement policy, allowing employees to receive pensions with fewer years of service. Combined with allegations - confirmed by a BCV employee - that some employees have already been notified of their "voluntary" retirements, this has fueled rumors that the GOV plans to gain control of key BCV management positions. Also, despite record high Venezuelan oil prices, the international reserves held by the BCV have not been increasing, leading to speculation that the GOV is either withholding oil income, or lying about how much it is. END SUMMARY.

MORE MONEY, MORE MONEY - FOREIGN EXCHANGE EARNINGS

¶2. (U) The Venezuelan Central Bank recently turned over to the GOV 1.5 trillion bolivars (USD 780 million) in foreign exchange earnings for the first half of 2004. However, Trino Alcides Diaz, the Banking Superintendent (who reports to Finance Minister Nobrega), criticized the BCV's accounting. He initially estimated that it owed an additional one trillion bolivars, but soon increased that to 2.5 trillion (USD 1.3 billion). Several private economists said this would increase inflation - one called it "hyper-inflationary" - and also stated that the bolivar would be weakened, since this would cause an enormous increase in the money supply without a backing in the international reserves, issues which Diaz did not address. The Superintendency may also attempt to apply the same method to older transactions, which could create an additional amount as high as 5 trillion bolivars owed for the period from 1989 to 1999.

NEW RETIREMENT PLAN - AKA HOSTILE TAKEOVER?

¶3. (U) On September 15, BCV Director Domingo Maza Zavala announced a new Central Bank retirement plan, which would allow some employees receive pensions with fewer years of service. Rumors immediately spread that certain employees, particularly managers in the divisions of national and international operations, as well as statistics, would be forced to retire. These are areas which are generally considered to have asserted their independence by publishing information that goes against GOV desires, and retirement would make it easier to pack management with government sympathizers. Rodrigo Cabezas, National Assembly Finance Committee chairman (of the pro-GOV MVR party), stated that the BCV directorate had denied these rumors, which circulated as soon as the plan was put into effect.

¶4. (C) However, BCV researcher Reinier Schliesser told econoff on September 30 that the forced retirements were, in fact, real. He noted that letters notifying employees of their retirement seemed to originate with the Human Resources Director, who has only been at the BCV a few months. Schliesser also asserted the employees now eligible to retire were placed into three different lists: those to dismiss soon, those to dismiss eventually, and those to definitely keep. The first phase had begun, and dismissed employees would receive their notification letter at noon, plus a box for their belongings. A guard would return at 4:00 to inspect the box and escort the employee out of the building. Schliesser stated that the reason the forced retirements were being done gradually was to avoid the disruption created in

PDVSA by the mass firings there.

WHERE HAVE ALL THE OIL PROFITS GONE?

¶5. (U) Venezuelan reserves on September 23 totaled USD 21.59 billion, which included USD 706 million in the Macroeconomic Stabilization Fund (FEM). Accounting for a USD 2.5 billion debt buyback by PDVSA on August 2, this is essentially the same level of reserves as on April 23 (USD 24.09 billion). Credit Suisse First Boston estimates that the GOV receives an average of USD 80 million per day from oil revenues. However, it estimates that only about USD 45 million is being sold per day via officially approved exchange transactions. Since this is the primary outlet for foreign reserves, it appears that total income is somewhat less than expected. This could mean that either PDVSA is diverting funds again, either by keeping them in accounts offshore or in the fund established earlier this year for "development" and administered by PDVSA (reftel B), or that oil production has taken a sudden drop.

¶6. (C) Oil sector sources have yet to perceive such a drop in production, so the diversion of funds is the likely explanation. Banco Mercantil economist Luis Zambrano believes that the GOV has determined that the ideal amount of reserves is between USD 21 and 22 billion, and will simply divert PDVSA income into offshore accounts to prevent the reserves from increasing beyond that. He also believes that PDVSA has, this year, diverted at least USD 3.5 billion into such funds. (Note: That this amount is higher than the announced USD 2 billion ceiling on the social fund is plausible, as President Chavez and PDVSA chairman Ali Rodriguez have both declared that the PDVSA social fund was rotating in nature; that is, when money is spent, more money can be diverted into the fund, making it an unlimited source of extra-budgetary spending. Maza Zavala disagreed with that interpretation.) Zambrano speculated the GOV is using this money to make foreign purchases (such as food for the MERCAL program), or loaning the funds (through BANDES, the GOV-owned Development Bank) to importers.

INDIRECT PRESSURES

¶7. (C) Efrain Velazquez, President of the National Economic Council (a private sector group created in 1946 to advise the President on economic issues, but which has not formally met with the current administration in over 18 months), told econoff on September 27 that the GOV's plan was to "get rid of the people with rational ideas" in the BCV. He noted that Minister of Finance Tobias Nobrega had been critical in an interview televised August 28, saying that the institution "has been something of a straggler in their way of determining problems." Nobrega added that BCV employees, when considering their job, think that "my responsibilities are these, so I won't get myself involved in working on other subjects." Velazquez added that BCV employees he has spoken with have said that they haven't felt free to talk openly over the phones at work in two to three years; Schliesser concurred.

COMMENT

¶8. (C) The forced retirements and the pressure for extra profits are an assault on the autonomy of the BCV as an institution. It appears the reason is a desire for more money, with no regard to negative consequences, such as inflation which may eventually come to pass, but also to control statistical information emanating from the Bank. The term of current BCV President Diego Castellanos, as well as those of several other Directors, is up in early 2005. The short list of candidates to replace Castellanos, according to Schliesser, are Finance Minister Nobrega (Schliesser termed the position Nobrega's "dream job"), Guillermo Ortega (a little known advisor to Nobrega), Banking Superintendent Trino Alcides Diaz, PDVSA Vice President Jose Rojas, and FOGADE (Deposit Guarantee Fund, FDIC equivalent) President Jesus Caldera Infante. For now, the GOV's need for funds is not that pressing, given strong oil prices and the openness of international markets to Venezuelan borrowing. However, should need for an easier monetary policy (not to mention some statistical massaging) arise in the future, the GOV may have sufficient control of the BCV to effect it.
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